IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

EUGENIO POSTORIVO, for himself and derivatively on behalf of KEE ACTION HOLDINGS, INC., a Delaware corporation, et al.,	)	
Plaintiffs,	)	Consolidated Civil Action No. 2991-VCP
v.	)	
AG PAINTBALL HOLDINGS, INC., a Delaware corporation, et al.,	)	
Defendants.	)	

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

KEE ACTION SPORTS HOLDINGS, INC., et al.,	)	
Plaintiffs,	)	**Civil Action No. 3111-VCP**
v.	)	
EUGENIO POSTORIVO, et al.,	)	**Transferred Pursuant to 10 Del. C. §1902**
Defendants.	)	

BRIEF IN SUPPORT OF DEFENDANTS'
MOTION TO DISMISS THE FIRST AMENDED VERIFIED COMPLAINT

TABLE OF CONTENTS

Page

I. PRELIMINARY STATEMENT 1

II. STATEMENT OF THE NATURE AND STAGE OF THE PROCEEDING 4

III. STATEMENT OF RELEVANT BACKGROUND INFORMATION AND FACTUAL ALLEGATIONS 6

A. The Asset Acquisition Transaction 6

B. Postorivo's Roles in the Post-Acquisition Companies 7

C. KEE Action Sports' Contract Indemnity Claims and Other, Employment-Related Conflicts 7

D. The Claims in the Sellers' Complaint 9

E. Minority Ownership Positions With Respect to the KEE Action Sports Entities 10

IV. STATEMENT OF QUESTIONS INVOLVED 13

V. ARGUMENT 14

A. Legal Standard for Motion To Dismiss 14

B. KEE Action Sports Holdings, Inc. Is Not A Plaintiff in this Action, and All Claims Purportedly Asserted by It Must Be Dismissed 15

C. Postorivo Does Not Have Standing To Assert Derivative Claims 16

D. Postorivo Is Not An Adequate Derivative Plaintiff 17

1. Postorivo cannot represent the interests of the company because he is positionally and economically materially adverse to the company in this same litigation, and the remedies he seeks are overwhelmingly self-interested 18

2. Postorivo was a director of KEE Action Sports Holdings, Inc. during the time of the alleged misconduct 21

3. Even when he was a shareholder, Postorivo was not the only minority shareholder 22

E. The Plaintiffs Have Failed To Adequately Plead Demand Futility 22

1. The Complaint contains no particularized allegations that could support a reasonable doubt regarding the disinterestedness and independence of the KEE Action Sports Holdings, Inc.'s directors. 23

2. The Complaint contains no particularized allegations suggesting that the challenged board actions were anything other than the product of the valid exercise of protected business judgment. 24

VI. CONCLUSION 26

TABLE OF AUTHORITIES

Page

CASES

A.R. DeMarco Enterprises, Inc. v. Ocean Spray Cranberries, Inc., No. 19133-NC, 2002 WL 31820970 (Nov. 26, 2002) 24

Aronson v. Lewis, 473 A.2d 805 (Del. Supr. 1984) 22, 24

Brehm v. Eisner, 746 A.2d 244 (Del. Supr. 2000) 14, 23, 25

Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. Supr. 1988) 16

Grobow v. Perot, 539 A.2d 180 (Del. Supr. 1988) 14

In re Fuqua Indus. S'holder Litig., 752 A.2d 126 (Del. Ch. 1999) 18

In re Santa Fe Pacific Corp. S'holder Litig., 669 A.2d 59 (Del. Supr. 1995) 14

Katz v. Plant Indus., Inc., 1981 WL 15148 (Del. Ch. Oct. 27, 1981) 18, 19

Khanna v. McMinn, No. 20545-NC, 2006 WL 1388744 (Del.Ch. May 09, 2006) 17

Kramer v. Western Pacific Industries, Inc., 546 A.2d 348 (Del. Supr. 1988) 5

Lewis v. Anderson, 477 A.2d 1040 (Del. Supr. 1984) 16

Lewis v. Straetz, 1986 WL 2252 (Del.Ch. Feb. 12, 1986) 15

Miller v. American Real Estate Partners, L.P., No. 16788, 2001 WL 1045643 (Del. Ch. Sept. 6, 2001) 13

Scopas Technology Co. v. Lord, No. 7559, 1984 WL 8266 (Del. Ch. Nov. 20, 1984) 20

White v. Panic, 783 A.2d 543 (Del. Supr. 2001) 14, 22

Youngman v.Tahmoush, 457 A.2d 376 (Del. Ch. 1983) 19

STATUTES

10 *Del. C.* §1902 1

8 *Del. C.* §225 9

I. PRELIMINARY STATEMENT

Both cases in this consolidated proceeding concern the November 2006 acquisition (the "Transaction") by KEE Action Sports, LLC and certain affiliated entities of substantially all of the assets of National Paintball Supply, Inc. ("NPS," now known as PBS Holding Group, Inc.) and its affiliates (the "NPS businesses" or, together with Eugenio Postorivo ("Postorivo"), the "Sellers").[1] The Transaction was and is governed by a definitive asset purchase agreement (as amended and together with its numerous ancillary agreements, exhibits and schedules, the "APA"). Postorivo – the sole owner, President and CEO of the NPS businesses – was to play an important role in the post-Transaction enterprise, and in fact served on the boards of two of the purchasing entities, KEE Action Sports, LLC and KEE Action Sports Holdings, Inc., and as President of KEE Action Sports, LLC (reporting to that company's CEO) until his termination in early May this year.

Regrettably, soon after the Transaction was consummated, significant disputes arose regarding the Sellers' representations, warranties and covenants – particularly with respect to acquired product inventories and undisclosed liabilities. Significant disputes also arose regarding Postorivo's job performance. Attempts to resolve these disputes amicably were unsuccessful. Consequently, the purchasers (the "Buyers") filed a contract indemnity action (now consolidated with this action) against the Sellers – including Postorivo – in the Delaware Superior Court on May 4, 2007. At about the same time, Postorivo's employment was terminated and he was dismissed from both boards.

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[1] The parties in this lawsuit are involved in the paintball gaming industry. Paintball gaming began in the early 1980s and since has grown into a significant segment of the "action sports" industry. While there is a virtually limitless variety of paintball games, most involve a field of play (ranging from natural woods to an open stadium), an objective (such as "capture the flag"), and the elimination of opponents by "marking" them with biodegradable, non-toxic paint capsules fired from a paintball "gun" or "marker."

The Buyers' May 4 Superior Court complaint (the "Indemnity Claim Complaint") was met with overlapping filings by the Sellers in multiple fora and states. The thirteen-count complaint filed in this Court (as amended, the "Complaint") is among those filings. In it, Postorivo and the other Sellers purport to allege direct and derivative claims for fraud, waste, breach of fiduciary duty, conversion, breach of contract, and declaratory and injunctive relief under 8 Del. C. §225, among others things. All of these claims are asserted against KEE Action Sports Holdings, Inc. and the other Buyers, either directly or through aiding and abetting and conspiracy claims. Curiously, the Complaint also purports to assert *direct* claims *by* KEE Action Sports Holdings, Inc.; that is, KEE Action Sports Holdings, Inc. is named as both a party plaintiff and a party defendant in the Complaint.

This motion is narrowly-tailored, and seeks dismissal of (1) the claims in the Complaint purportedly asserted by KEE Action Sports Holdings, Inc. and (2) the derivative claims purportedly asserted by Postorivo on behalf of KEE Action Sports Holdings, Inc.[2] As explained below:

- The Blank Rome law firm does not now, nor has it ever, represented KEE Action Sports Holdings, Inc. In fact, as evident from the Complaint and other filings by the Sellers in this action, Blank Rome's purported representation here presents a serious conflict of interest in that (a) Blank Rome was adverse to KEE Action Sports Holdings, Inc. in connection with the negotiation of the Transaction now being litigated and, worse, (b) Blank Rome is prosecuting claims directly against KEE Action Sports in this same

[2] The KEE Action Sports entities and AG Paintball Holdings, Inc. and Messrs. Leffel and Dombrowski, who are not among the Buyers but who also are named as defendants in the Complaint, filed an answer to the claims in the Complaint as to which no motion to dismiss is pending on July 2, 2007.

litigation. KEE Action Sports has not waived this conflict, nor is this conflict waivable under Delaware Lawyers' Rule of Professional Conduct 1.7(3).

- Postorivo has no standing to pursue derivative claims on behalf of KEE Action Sports Holdings, Inc., since, as is clear from the allegations of the Complaint, he is not a shareholder, not an officer and not a director of that entity.
- Postorivo is not an adequate representative plaintiff for purposes of derivative claims. First, as is clear from the Complaint, he is in direct conflict with and therefore antagonistic to KEE Action Sports Holdings, Inc. by virtue of the claims he is asserting against KEE Action Sports Holdings, Inc. in this same case. Second, he was a director of both KEE Action Sports Holdings, Inc. and KEE Action Sports, LLC at all relevant times, meaning that he participated in, ratified or otherwise acquiesced to the alleged misconduct he now challenges. Third, it is clear that Postorivo seeks by this action to greatly augment the merger consideration he received in the Transaction – an objective which is fundamentally at odds with the interest of the KEE Action Sports entities. Of note, there are two other sophisticated minority shareholders (Blue Ridge Investments, LLC (a Bank of America affiliate) and Citicorp USA, Inc. (affiliated with CitiGroup)), which could pursue derivative claims but, tellingly, have not.
- Postorivo has failed to adequately plead demand futility – a defect that is particularly significant here in light of Postorivo's obvious conflict of interest.

II. STATEMENT OF THE NATURE AND STAGE OF THE PROCEEDING

The Indemnity Claim Complaint Filed by the Buyers.

This litigation was commenced on May 4, 2007 when the Buyers filed their contract indemnity action against the Sellers in the Delaware Superior Court styled, *KEE Action Sports Holdings, Inc., et al. v. Eugenio Postorivo, et al.*, Civil Action No. 07C-05-062 PLA. The claims in that action, which were consolidated with this action by order dated June 20, 2007, involve essentially claims for money damages (in excess of $11 million) under the APA's indemnity provisions. The indemnity claims concern alleged widespread deficiencies in the inventory acquired in the Transaction and other undisclosed liabilities. Misrepresentation and unjust enrichment claims also are asserted. *See* Transferred Indemnity Claim Complaint filed of record in the Court of Chancery on July 22, 2007. These claims are not directly at issue in this motion, but are described below in Section III because they (among other things) illustrate the very serious adversity that now exists between and among Postorivo and the other Sellers, on the one hand, and the KEE Action Sports entities (*i.e.*, the Buyers) on the other hand.

The Instant Complaint.

On May 29, 2007, the Sellers filed their Verified Complaint in this Court, which was amended on June 26, 2007.[3] The claims, which are described generally in Section III below, are asserted against the Buyers and also against AG Paintball Holdings, Inc.,[4] Raymond E. Dombrowski, Jr. in his capacity as a director and officer of various KEE entities, and Brent

[3] On June 1, 2007, days after filing the Complaint in this Court, Postorivo filed suit in the Chancery Division of the Superior Court of New Jersey seeking essentially a subset of the relief he sought in this case – declaratory and injunctive relief in connection with the allegedly unlawful termination of his employment agreement. *Postorivo v. KEE Action Sports, LLC*, C.A. C-50-07 (Superior Court of New Jersey, Gloucester County, Chancery Division). Postorivo since has withdrawn the New Jersey action.

[4] AG Paintball Holdings, Inc. is a special purpose vehicle used to hold the equity and debt investments of KEE Action Sports Holdings, Inc. No allegations are made specifically against this entity in the Complaint.

Leffel in his alleged capacity as "Chairman and a Director of" KEE Action Sports Holdings, Inc. and KEE Action Sports, LLC.[5] Curiously, KEE Action Sports Holdings, Inc. – one of the defendants in the Complaint – also is identified as a party plaintiff. *See* Complaint, ¶ 3; *see also* caption and ¶ 3 of the May 29, 2007 Verified Complaint.

The Complaint purports to assert derivative and direct claims, but offers little guidance as to which specific claims are intended to be derivative, which are direct, or which if any are both derivative and direct. Rather, each of the 13 claims purports to be asserted by the "Plaintiffs" without further elaboration.[6]

The Answer, Counterclaim and Motion to Dismiss Directed to the Complaint.

The Defendants named in the Complaint filed an answer and counterclaim[7] to those claims not subject to this motion on July 2, 2007, expressly preserving in their answer the right to seek dismissal of the unanswered claims. The Defendants also filed their motion to dismiss on July 2, and submit this brief in accordance with the stipulated scheduling order submitted to the Court on July 23, 2007.

[5] The Buyers, along with AG Paintball Holdings, Inc. and Messrs. Leffel and Dombrowski, are referred to in the Complaint as the "Defendants." When used in this brief, that term will have the same meaning as in the Complaint.

[6] The waste claim, of course, is classically a derivative claim. *See Kramer v. Western Pacific Industries, Inc*., 546 A.2d 348, 353 (Del. Supr. 1988) ("A claim of mismanagement resulting in corporate waste, if proven, represents a direct wrong to the corporation that is indirectly experienced by all shareholders" and is therefore "entirely derivative in nature."). As to the remaining claims, however, the Plaintiffs' intentions are not self-evident.

[7] The Counterclaim is based on an option provided to two of the KEE Action Sports entities in the APA. The option pertains to certain third party litigation, and is not relevant to this motion other than to illustrate yet another level on which Postorivo's interests are directly adverse to those of KEE Action Sports Holdings, Inc. and *vice versa.*

III. STATEMENT OF RELEVANT BACKGROUND INFORMATION AND FACTUAL ALLEGATIONS

A. The Asset Acquisition Transaction

According to the Complaint, NPS' revenues peaked in the 2004-2006 time frame; thereafter, NPS "experienced a market downturn attributable to both the stagnation of new paintball interest, and a significant dispute between NPS and one of its major, exclusive suppliers . . . ." which "affected the company's bottom line through 2006." Complaint, ¶ 49. Concerns arising from this downturn prompted Postorivo "to pitch the NPS assets . . .", with the Defendants emerging as "the primary interested party." *Id.* at ¶ 50. A deal was negotiated, and in November 2006, substantially all of the assets of the NPS businesses[8] and an unrelated company called Pursuit Marketing, Inc. were combined to form one of the largest providers of paintball equipment and accessories in the paintball gaming industry. *See Id.* at ¶ 51 and Exhibit A incorporated therein. The combination was effected through contemporaneous, arms' length asset acquisition transactions funded with private equity capital and third party debt. *See Id*. at ¶¶ 50 and 51.

The Transaction was and is governed by the APA, which is incorporated by reference in and therefore part of the Complaint.[9] *Id.* at ¶ 56. As evident from the APA, the Sellers consist of: NPS, Paintball 2 X-tremes, Inc. (now known as PBS Holding Group X-tremes, Inc.), Empire Sports, LLC (now known as PBS Holding Group 1, LLC), Kings View Associates Limited, and Postorivo, the sole owner, President and CEO of the NPS businesses. The Buyers include: KEE

[8] According to the Complaint, the acquired assets included without limitation NPS' interest in leased real property, inventories, prepaid items, machinery, equipment and other personal property, contracts, intellectual property including trademarks, patents, copyrights, trade secrets and domain names, security deposits, the Sellers' goodwill, purchase orders, guarantees, receivables, cash investments, customer and vendor relationships, all brands, the website and "any other significant operating asset of the [NPS] business." *Id.* at ¶ 57.

[9] Court of Chancery Rule 10(c).

Action Sports Holdings, Inc. (f/k/a AJ Acquisition Holdings, Inc.), KEE Action Sports, LLC (f/k/a AJ Intermediate Holdings, LLC), KEE Action Sports I, LLC (f/k/a AJ Acquisition I, LLC) and KEE Action Sports I UK Limited (f/k/a AJ Acquisition I UK Limited).

B. Postorivo's Roles in the Post-Acquisition Companies

In connection with the Transaction, Postorivo was appointed to the boards of both KEE Action Sports Holdings, Inc. and KEE Action Sports, LLC. *Id.* at ¶ 67. He served as a director on those boards until his removal on May 4, 2007. *See Id*. at 93 and termination notice referenced therein. Additionally, Postorivo became the President of KEE Action Sports, LLC under the terms of a written employment agreement (as amended, the "Employment Agreement"), which is incorporated in and therefore part of the Complaint. *Id.* at ¶ 67. As is clear from the Employment Agreement, Postorivo was to report to the company's CEO (Raymond Dombrowski):

> The Executive [Postorivo] shall report to and otherwise shall be subject to the direction and control the Board of Directors of the Company (as constituted from time to time, the "Board"), or, as so designated by the Board, the Company's Chief Executive Officer.

Id. at Exhibit C ("First Amendment to Employment Agreement with Gino Postorivo" at ¶ 3).

Postorivo remained employed under the Employment Agreement until May 5, 2007, at which time he was terminated. *See Id.* at ¶ 95 and the Employment Termination Notice referenced therein.

C. KEE Action Sports' Contract Indemnity Claims and Other, Employment-Related Conflicts

As alleged in the Indemnity Claim Complaint, within months of consummating the Transaction, the Buyers began to discover pervasive, undisclosed inventory variances in violation of the Sellers' representations, warranties and covenants. *See Id.* at ¶¶ 91-92 and the Indemnity Claim Complaint referenced therein. In particular, the Buyers allege that substantial

quantities of inventory included in the acquired assets and recorded in the NPS businesses' records and financial statements were found to be obsolete, slow-moving or altogether unsaleable, defective, and in some instances, non-existent. Indemnity Claim Complaint, ¶ 34.

The Indemnity Claim Complaint further alleges that Sellers, including and especially Postorivo, had actual knowledge of these inventory problems when the APA was executed. *Id.* at ¶¶ 5, 6, 7, 34 and 35. The volume of the inventory in dispute is significant, representing nearly 70% of the total inventory acquired in the Transaction and requiring an additional write-off representing nearly 40% of the total inventory value. *Id.* at ¶ 35. As of the filing of the Indemnity Claim Complaint on May 4, 2007, the Buyers had identified alleged valuation variances totaling approximately $8.7 million – an amount *vastly* greater than the $2.5 million total reserve provided by the APA. *Id.* at ¶ 36.

In short, the claims alleged in the Indemnity Claim Complaint are substantial, serious, and underscore the fact that Postorivo and the Buyers – the latter including KEE Action Sports Holdings, Inc. – are *materially* adverse to one another.

Other significant points of contention also exist. Disputes over Postorivo's performance in his role as President of KEE Action Sports, LLC eventually resulted in his termination (a decision that he seeks to reverse in this lawsuit). As set forth in the Employment Termination Notice incorporated in and attached to the Complaint (¶ 95) at Exhibit H, he was terminated based in part on the following grounds:

> (1) You [Postorivo] have advised Michael Snyder, Esquire, counsel to the Company, that he is operating under a conflict of interest in representing the Company contrary to your interests and the interests of the entities that you control. Mr. Snyder's continued representation of the Company is important to the Company's interest and his continued representation of the Company is in no way in conflict with your personal interests. To the contrary, Mr. Snyders representation of the Company is

perfectly aligned with your interests, namely to ensure that the Company has valid legal title to all of the assets delivered by you under the Asset Purchase Agreement.

(2) You have failed as President of the Company to accurately disclose the condition of the Company's inventory, much of which the Company's investigation has found to be obsolete, defective, slow-moving or non-existent. Despite requests by the Company, you have refused to assist the Company in understanding and rectifying the inventory problems.

(3) By your own admission during the January 24, 2007 Board meeting, you failed to disclose to the Company the existence of oral purchase orders for goods from a critical vendor, thus exposing the Company to liabilities in excess of $1 million. You confirmed that admission by your approval of the minutes of that meeting at the Board meeting of March 22, 2007.

(4) You have routinely been absent from work without any explanation or permission.

(5) In connection with certain unrelated claims that you retained against Procaps, and in contravention of the Company's directives, you discussed with representatives of Procaps matters related to the Company's litigation with Procaps concerning the Pulse loader.

(6) You have regularly used Company assets while on Company time to conduct personal business.

(7) Despite repeated requests of the Company, you have refused to fulfill your obligations with respect to certain vendor liabilities not assumed by the Company, resulting in the Company being forced to incur economic and other losses in dealing with claims made against it by such vendors.

Complaint at ¶ 105 and Exhibit H.

D. The Claims in the Sellers' Complaint

As stated above, the Complaint purports to assert direct and derivative claims for fraud, waste, breach of fiduciary duty, conversion, breach of contract, and declaratory and injunctive relief under 8 Del. C. §225. Among many other things, the Complaint alleges that:

- the Defendants developed a pre-Transaction scheme whereby they conspired to fraudulently deprive Postorivo of participation in the post-Transaction business and of the consideration he received in the Transaction. *See* Complaint, ¶¶ 75, 86 and 87;

- the Defendants have conspired to artificially deflate the value of the post-Transaction businesses to "manufacture" false indemnity claims as "part of the grand scheme to freeze out and eliminate Postorivo . . . ." *Id.* at ¶¶ 84 and 86;

- the Defendants have intentionally sold off inventory at "liquidation fire sale prices" not for legitimate business reasons, but "to show their lenders an artificially formulated balance sheet that would present a skewed financial picture of the company after the merger of assets." *Id.* at ¶ 84;

- the Defendants "fraudulently" removed Postorivo from the board of directors of KEE Action, Inc. *Id.* at ¶ 93 and corresponding heading;

- the Defendants have "improperly" terminated Postorivo's employment based on "manufactured grounds". *Id.* at ¶¶ 94 and 107 and corresponding heading;

- the Defendants have improperly stripped Postorivo of his shares under a contractual forfeiture provision "as part of a contrived and organized conspiracy to obtain the assets of NPS at the expense of Postorivo . . . ." *Id.* at ¶¶ 112-13; and

- the Defendants have improperly interfered with potentially valuable third-party litigation retained by NPS (but subject to an Option held by certain of the KEE entities) in an effort to settle that matter behind Postorivo's back. *See Id.* at ¶¶ 114-120.

Again, it is evident from these allegations that the parties are materially adverse.

E. <u>Minority Ownership Positions With Respect to the KEE Action Sports Entities</u>.

Postorivo currently has no ownership position whatsoever in KEE Action Sports Holdings, Inc. or any of the KEE Action Sports entities. *Id.* at ¶ 112.

In connection with the Transaction, Postorivo received 10% of the fully diluted common stock of KEE Action Sports Holdings, Inc. and the right to be assigned $5 million in junior preferred stock. *Id.* at ¶ 58. As the Complaint makes clear, KEE Action Sports Holdings, Inc. exercised its rights under forfeiture provisions contained in the APA and a Restricted Stock Agreement (attached to the Complaint) to recover those shares from Postorivo. *Id.* at ¶ 112 and

Notices of Transfer of Shares attached to Complaint at Exhibit I. The Notices of Transfer of Shares attached to the Complaint state:

> You [Postorivo] are hereby notified that KEE Action Sports Holdings, Inc. (formerly known as, AJ Acquisition Holdings, Inc. and herein referred to as the "Company"), has exercised its rights pursuant to the Restricted Stock Agreement, as amended, between you and the Company, to cancel Two Hundred Fifty Thousand (250,000) Unvested Shares of the Company's Voting Common Stock (the "Common Shares") previously issued to you. This action is taken as a result of the termination of your employment for Cause pursuant to your Employment Agreement with KEE Action Sports, LLC.
>
> Subordinated to the foregoing act, the Company has also exercised its rights under the Pledge Agreement dated November 17, 2006 to transfer to the Company One Hundred Twenty-five (125,000) of the Common Shares.
>
> Further, the Company has exercised its rights under the Pledge Agreement dated November 17, 2006 to transfer to the Company 100,000 shares of the Company's Series B Junior Preferred Stock represented by Certificate B-1 (the "Preferred Shares") that were previously issued by the Company to PBS Holding Group, Inc. (formerly known as National Paintball Supply, Inc.), in the event that such Preferred Shares were assigned to you.

Complaint, Exhibit I.

Consequently, Postorivo is not a shareholder of KEE Action Sports Holdings, Inc., and in fact by this action hopes to recover his forfeited shares.

Also evident from the Complaint, there were two other minority shareholders in KEE Action Sports Holdings, Inc. who remain shareholders. Bank of America (through a wholly owned subsidiary called "Blue Ridge Investments, LLC") and CitiGroup (through a subsidiary called "Citicorp USA, Inc.") each have a minority position in KEE Action Sports Holdings, Inc. According to the schedule ("Post Closing Capitalization (Equity) of AJ Acquisition Holdings, Inc.") attached at Exhibit B to the Employment Agreement (Exhibit C to the Complaint), Bank

of America acquired 10,000 Series A Preferred shares and Citigroup acquired 5,000 Series A Preferred shares in KEE Action Sports Holdings, Inc.[10] Accordingly, while Postorivo currently owns no shares in KEE Action Sports Holdings, Inc., two sophisticated investors do. Their rights are implicated and potentially impacted by Postorivo's overwhelmingly self-interested claims ostensibly on behalf of and certainly those against KEE Action Sports Holdings, Inc.

[10] These shareholders also are identified in and parties to the Stockholders' Agreement executed by Postorivo along with the APA on November 17, 2006. The Stockholders' Agreement was contained in and part of the Transaction closing binders.

IV. STATEMENT OF QUESTIONS INVOLVED

1. Is KEE Action Sports Holdings, Inc. appropriately denominated a party plaintiff in the Complaint? No. KEE Action Sports Holdings, Inc., which also is named as a defendant in the Complaint, has not consented to be a plaintiff with respect to the claims in the Complaint, is not represented by Blank Rome, and cannot be represented by Blank Rome due to unwaivable conflicts of interest. The claims purportedly asserted by KEE Action Sports Holdings, Inc. must be dismissed from the Complaint.

2. Does Postorivo have standing to pursue derivative claims on behalf of KEE Action Sports Holdings, Inc.? No. As is clear from the allegations of the Complaint, he is not a shareholder, not an officer and not a director of that entity.

3. Does Postorivo satisfy the adequacy requirements for a representative plaintiff for purposes of derivative claims? No. As is clear from the pleadings in this litigation, he is directly adverse to KEE Action Sports Holdings, Inc. by virtue of the claims asserted against him by KEE Action Sports Holdings, Inc. and, of course, the claims he is asserting against KEE Action Sports Holdings, Inc.; he was a director of both KEE Action Sports Holdings, Inc. and KEE Action Sports, LLC at all relevant times, meaning that he participated in, ratified or otherwise acquiesced to the alleged misconduct he now challenges; and it is clear from the Complaint at large that Postorivo seeks by this action to augment the merger consideration he received in the Transaction – an objective which is fundamentally at odds with the interest of the KEE Action Sports entities. Of note, there are two other sophisticated minority shareholders (Blue Ridge Investments, LLC (a Bank of America affiliate) and Citicorp USA, Inc. (affiliated with CitiGroup)), which could protect the minority shares if necessary, and whose interests in this case are adverse to Postorivo's.

4. **Has demand futility been adequately pleaded for purposes of the derivative claims?** No. The Complaint fails to allege any facts that could support the conclusion that the board of directors of KEE Action Sports Holdings, Inc. is incapable of objectively evaluating claims against Messrs. Leffel and Dombrowski, or that their actions are outside the scope of the business judgment rule.

V. ARGUMENT

A. Legal Standard for Motion To Dismiss

When considering a motion to dismiss, the court must assume the truth of all well-pleaded facts. *Miller v. American Real Estate Partners, L.P.*, No. 16788, 2001 WL 1045643, *6 (Del. Ch. Sept. 6, 2001). Plaintiffs are entitled to all reasonable factual inferences that logically flow from the particularized facts alleged, but the court need not give weight to conclusory allegations that are unsupported by specific allegations of fact. *White v. Panic*, 783 A.2d 543, 549 (Del. Supr. 2001) (affirming dismissal under Rule 23.1); *see also Miller at* *6. That is, "'[a] trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in plaintiffs' favor unless they are reasonable inferences.'" *Grobow v. Perot*, 539 A.2d 180, 187 & n.6 (Del. Supr. 1988), *overruled on other grounds by, Brehm v. Eisner,* 746 A.2d 244 (Del. Supr. 2000) (dismissal of shareholder derivative action subject to *de novo* review). The court may dismiss the complaint "only if it is reasonably certain that the facts pled in the complaint would not support any claim for relief." *Miller* at *6.

There is a well-recognized exception to the rule that a motion to dismiss must be converted to a summary judgment motion in cases where the submitted document is integral to plaintiff's claim and it is incorporated into the complaint. *See In re Santa Fe Pacific Corp. S'holder Litig.*, 669 A.2d 59, 69 (Del. Supr. 1995). Court of Chancery Rule 10(c) provides that "[a] copy of any written instrument which is an exhibit to a pleading is a part thereof for all purposes." "[W]hen plaintiff fails to introduce a pertinent document as part of his pleading, defendant may introduce the exhibit as part of his

motion attacking the pleading. . . ." *Lewis v. Straetz*, 1986 WL 2252, at *3 (Del.Ch. Feb. 12, 1986) (referring to Del. Ch. R. 10(c)).

B. KEE Action Sports Holdings, Inc. Is Not A Plaintiff in this Action, and All Claims Purportedly Asserted by It Must Be Dismissed

As stated above, KEE Action Sports Holdings, Inc. is identified as a party plaintiff in the Complaint. The Complaint fails to establish that KEE Action Sports Holdings, Inc. has agreed to participate as a plaintiff or otherwise has authorized claims against itself, its affiliates, and two of its officers and directors. Of course, it has not, and the fact that KEE Action Sports Holdings, Inc. has been simultaneously named as a party plaintiff and a party defendant in the Complaint presents a facially untenable situation.

Additionally, the Complaint fails to identify any basis upon which to conclude that KEE Action Sports Holdings, Inc. has consented to representation by Blank Rome. This is particularly troubling because such a representation would present a serious and unwaivable conflict of interest. As is clear from other filings by the Sellers in this action, Blank Rome represented the Sellers, and was therefore adverse to the Buyers (including KEE Action Sports Holdings, Inc.), in connection with the negotiation of the Transaction now in dispute.[11] More to the point, Blank Rome is representing the Sellers in connection with claims being asserted directly against KEE Action Sports Holdings, Inc. in this litigation. This, of course, presents a conflict that is not waivable under Delaware Lawyers' Rule of Professional Conduct 1.7(3) (providing that in a concurrent conflict scenario, a lawyer may represent a client only if "the

[11] By way of example, in the Sellers' Memorandum of Law in Support of Plaintiff's Motion to Preclude Defendants' Violation of the Attorney-Client Privilege and Improper Contact with Employees filed in this case on June 27, 2007, the Sellers state that, "During the negotiations for the asset sale, [NPS General Counsel John] Campo represented NPS and Postorivo, as the sole shareholder of NPS, along with attorneys from Blank Rome LLP." *Id.* at p. 5.

representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal . . .").[12]

KEE Action Sports Holdings, Inc. is not and cannot be a plaintiff for purposes of the Complaint, and all claims purportedly asserted by KEE Action Sports Holdings, Inc. must be dismissed.

C. Postorivo Does Not Have Standing To Assert Derivative Claims

The derivative claims must be dismissed because Postorivo does not have standing to assert them. Once a plaintiff ceases to be a stockholder, whether by reason of a merger or otherwise, he or she loses standing to bring a derivative suit. *Lewis v. Anderson*, 477 A.2d 1040, 1046 (Del. Supr. 1984) ("a derivative shareholder must not only be a stockholder at the time of the alleged wrong and at time of commencement of suit but . . . must also maintain shareholder status throughout the litigation."). Postorivo ceased to be a stockholder of KEE Action Sports Holdings, Inc. on May 14, 2007, when his shares were canceled. Complaint, ¶ 112.

The fact that Postorivo alleges that his shares were wrongly cancelled does not give him standing where standing otherwise does not exist. The holding in *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1188 (Del. Supr. 1988), *subsequent appeal at, remanded by*, 758 A.2d 485 (Del. Supr., 2000), is particularly instructive here. In *Cede*, the Supreme Court stated:

> Standing to pursue a derivative claim for injury to the corporate entity should not be confused with the right of a former shareholder claimant to assert a timely filed private cause of action premised upon a claim of unfair dealing, illegality, or fraud. No one would assert that a former owner suing for loss of property through deception or fraud has lost standing to right the wrong that arguably caused the owner to relinquish ownership or possession of the property.

[12] In fact, Blank Rome likewise would be conflicted from representing the interests of KEE Action Sports Holdings, Inc. *derivatively* by virtue of the direct claims being asserted by parties represented by Blank Rome against KEE Action Sports Holdings, Inc. in this litigation.

As a *former* stockholder, Postorivo lacks standing to be a derivative plaintiff. If he believes he has been wrongly deprived of his shares, which clearly he does, he may assert direct claims to right the alleged wrong, which he has done. That is his *sole* remedy. He may not, as he attempts to do here, make conclusory allegations of fraud, posit that, if true, those allegations will restore his status as a stockholder, and proceed in the name of the corporation on the chance that his shares someday will be returned.

Because, as evident from the Complaint, Postorivo is not a shareholder, director or officer of KEE Action Sports Holdings, Inc., he cannot assert derivative claims on its behalf. Accordingly, the derivative claims must be dismissed.

D. Postorivo Is Not An Adequate Derivative Plaintiff

Plaintiffs seeking to maintain derivative claims must satisfy the adequacy requirements implicit in Court of Chancery Rule 23.1. *Khanna v. McMinn*, No. 20545-NC, 2006 WL 1388744, *41 (Del. Ch. May 9, 2006). A "derivative plaintiff serves in a fiduciary capacity as representative of persons whose interests are in plaintiff's hands and the redress of whose injuries is dependent upon her diligence, wisdom and integrity." *Id.*

> A number of factors may be considered in determining whether a plaintiff is deemed "adequate" for these purposes:
>
> (1) economic antagonisms between the representative and the class;
>
> (2) the remedy sought by plaintiff in the derivative litigation;
>
> (3) indications that the named plaintiff was not the driving force behind the litigation;
>
> (4) plaintiff's unfamiliarity with the litigation;
>
> (5) other litigation pending between plaintiff and defendants;
>
> (6) the relative magnitude of plaintiff's personal interests as compared to her interest in the derivative action itself;

> (7) plaintiff's vindictiveness toward defendants; and
>
> (8) the degree of support plaintiff was receiving from the shareholders she purported to represent.
>
> [*In re Fuqua Indus. S'holder Litig.*, 752 A.2d 126, 130 (Del. Ch. 1999).]
>
> This list, however, is not exhaustive. "Typically, the elements are intertwined or interrelated, and it is frequently a combination of factors which leads a court to conclude that the plaintiff does not fulfill the requirements of 23.1...." [*Katz v. Plant Indus., Inc.*, 1981 WL 15148, *2 (Del. Ch. Oct. 27, 1981) (further citation omitted)]. It is possible that the inadequacy of a plaintiff may be concluded from a "strong showing of only one factor [; however,] that factor must involve some conflict of interest between the derivative plaintiff and the class." [*In re Fuqua*, 752 at 130].

Khanna, 2006 WL at *41 (footnotes omitted).

The circumstances of this litigation and, in particular, Postorivo's posture in this litigation, render Postorivo inadequate to serve as a derivative plaintiff representing KEE Action Sports Holdings, Inc. under virtually every factor.

1. Postorivo cannot represent the interests of the company because he is positionally and economically materially adverse to the company in this same litigation, and the remedies he seeks are overwhelmingly self-interested.

Postorivo's position in this litigation is irreconcilably adverse to KEE Action Sports Holdings, Inc. Postorivo has accused the company of conversion (Complaint, Count II), fraud (Count III), aiding and abetting and conspiracy in breaches of fiduciary duty and waste of corporate assets (Counts V and VI), breach of contract (Count VII), and breach of the covenant of good faith and fair dealing (Count VIII). The claims being asserted against Postorivo by the company are no less severe, and include allegations of intentional misrepresentation. Fundamentally, Postorivo seeks by his claims to recover Transaction consideration far beyond

what he now has, from a company that is alleging that it has been materially deprived of the benefit of its bargain in the Transaction due to Postorivo's intentional misconduct. Postorivo seeks reinstatement as President of the company which in turn has terminated that employment based on a detailed list of serious performance deficits and, worse, abuses of the position. Postorivo seeks reappointment to a board of directors of a company he simultaneously claims was being mismanaged while he was a member of the board – but did nothing about until his own interests were at issue.

In short, it is difficult to imagine how Postorivo's and the company's respective interests could be more materially at odds.

In *Katz v. Plant Indus., Inc.*, 1981 WL 15148, *2 (Del. Ch. Oct. 27, 1981), the Court listed the factors to be considered in determining whether a shareholder who meets the other requirements of Rule 23.1 is qualified to act as a derivative plaintiff on behalf of the corporation:

> Among the elements which the courts have evaluated in considering whether the derivative plaintiff meets Rule 23.1's representation requirements are: economic antagonisms between representative and class; the remedy sought by plaintiff in the derivative action; indications that the named plaintiff was not the driving force behind the litigation; plaintiff's unfamiliarity with the litigation; other litigation pending between the plaintiff and defendants; the relative magnitude of plaintiff's personal interests as compared to his interest in the derivative action itself; plaintiff's vindictiveness toward the defendants[] and, finally, the degree of support plaintiff was receiving from the shareholders he purported to represent.

The Court further emphasized that "[a] major type of antagonism requiring denial of certification is clear economic antagonism between representative and class." *Id.* (internal quotation omitted); *see also Youngman v.Tahmoush*, 457 A.2d 376, 379-80 (Del. Ch. 1983) (quoting *Katz*). Here, the economic antagonism between Postorivo and the company is direct and substantial, the relief sought in the litigation is overwhelmingly for the benefit of Postorivo, Postorivo is adverse

to KEE Action Sports Holdings, Inc. in this same litigation, and a general atmosphere of hostility now characterizes the parties' relationship.

In fact, the antagonism between Postorivo and the company is so palpable, it raises serious questions as to whether, by design or by happenstance, Postorivo's derivative claims are being or may in the future be used to leverage Postorivo's personal claims. This concern militated against permission of derivative claims in *Scopas Technology Co. v. Lord*, No. 7559, 1984 WL 8266 (Nov. 20, 1984). In that case, the corporation, Scopas, brought an action against Lord, a shareholder and former director and officer, for breach of fiduciary duty. Lord filed counter-claims against Scopas and three individual directors alleging breach of his employment agreement and asserting derivative claims for waste and breach of fiduciary duty. *Id.* The Court applied the *Katz* factors, finding that "the primary conflict springs from the other disputes or 'litigation' existing between Lord and Scopas." *Id.* at *2. The Court dismissed Lord's derivative claims, finding that the disparity between "Lord's interest in his personal claims as compared with his interest in the derivative suit. . . . creates a strong potential for the derivative suit to be used merely a[s] leverage, and not pursued with the same vigor as his direct claims." *Id.* at *3.[13]

Similarly, in *Khanna*, the Court observed that, with respect to derivative claims being asserted by a company's former general counsel who also sought reinstatement of his employment position:

> Khanna's employment dispute with Covad has impaired Khanna's capacity to vindicate shareholders' best interests. [Khanna's] letter to the Covad Board[] demonstrates a self-interested motivation that is not consistent with the continued pursuit of a derivative and class action by this plaintiff – a plaintiff on whom the Covad shareholders would be relying. The . . . letter makes clear that Khanna's

[13] The court in *Scopas* also considered the other *Katz* factors, finding that Lord's "hostility [toward the corporation] would handicap his ability to adequately represent the corporation and its shareholders in a derivative suit." *Id.* at *3.

> initial motive in threatening to bring the action was to provide leverage in his attempt to regain (and enhance) his position at Covad after his suspension as General Counsel.

Khanna, 2006 WL at *43. The Court found "ample history of bad will," and concluded that there was "a substantial likelihood that Khanna will not maintain and prosecute the action according to the best interests of the shareholders." *Id.* at *44.

Postorivo's interests are overwhelmingly at odds with those of the company's. He has accused KEE Action Sports Holdings, Inc. of fraud, conversion, breach of contract and aiding and abetting waste and breaches of fiduciary duty, among other things. Postorivo seeks for himself reappointment to the board, reinstatement of his employment, the return of his forfeited shares, and other damages inuring to his personal benefit. Postorivo and the company are directly adverse to one another – positionally and economically – in this litigation, creating "a strong potential for the derivative suit to be used merely a[s] leverage, and not pursued with the same vigor as his direct claims." *Scopas* at *7.

2. Postorivo was a director of KEE Action Sports Holdings, Inc. during the time of the alleged misconduct.

Additionally, the Complaint makes clear that Postorivo was himself a director when the alleged waste and breaches of fiduciary duty were occurring. The Complaint contains no allegations whatsoever insulating Postorivo from the alleged misconduct and mismanagement, or otherwise suggesting that he objected to it in any way (which he did not). The alleged improprieties occurred on Postorivo's watch but he did nothing about them then, further demonstrating (1) his inadequacy as a representative plaintiff and (2) that the so-called derivative claims are not now asserted out of concern for the company, but to serve Postorivo's own personal objectives in this litigation.

3. Even when he was a shareholder, Postorivo was not the only minority shareholder.

As described above, other minority shareholder interests are implicated by Postorivo's actions here. Blue Ridge Investments, LLC (a Bank of America subsidiary) and Citicorp USA, Inc. (a CitiGroup subsidiary) each own a minority interest in KEE Action Sports Holdings, Inc., and either could take measures to right any wrong done to their minority interests. Their rights are implicated and potentially impacted by Postorivo's overwhelmingly self-interested claims ostensibly on behalf of, and certainly those against, KEE Action Sports Holdings, Inc.

E. The Plaintiffs Have Failed To Adequately Plead Demand Futility

"In most situations, the board of directors has sole authority to initiate or to refrain from initiating legal actions asserting rights held by the corporation." *White v. Panic*, 783 A.2d 543, 550 (Del. Supr. 2001) (citing 8 Del.C. § 141(a)). This authority is "subject to the limited exception, defined in Chancery Rule 23.1, permitting stockholders to initiate a derivative suit to enforce unasserted rights of the corporation without the board's approval where they can show either that the board wrongfully refused the plaintiff's pre-suit demand to initiate the suit or, if no demand was made, that such a demand would be a futile gesture and is therefore excused." *Id.*

Where a stockholder files a derivative action without first making a demand on the corporation's board of directors, Court of Chancery Rule 23.1 requires the stockholder to allege with particularity the reasons for not making the demand. *Id.* In *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984) (emphasis added), the Supreme Court established the standard for demand futility:

> [I]n determining demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the *particularized facts alleged*, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment. "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the

> plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." Ch. Ct. R. 23.1.

In *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000), the Supreme Court elaborated on the pleading requirements for derivative complaints:

> Those pleadings must comply with stringent requirements of factual particularity that differ substantially from the permissive notice pleadings governed solely by Chancery Rule 8(a). Rule 23.1 is not satisfied by conclusory statements or mere notice pleading. On the other hand, the pleader is not required to plead evidence. What the pleader must set forth are particularized factual statements that are essential to the claim. Such facts are sometimes referred to as "ultimate facts," "principal facts" or "elemental facts." Nevertheless, the particularized factual statements that are required to comply with the Rule 23.1 pleading rules must also comply with the mandate of Chancery Rule 8(e) that they be "simple, concise and direct." A prolix complaint larded with conclusory language, like the Complaint here, does not comply with these fundamental pleading mandates.

1. The Complaint contains no particularized allegations that could support a reasonable doubt regarding the disinterestedness and independence of the KEE Action Sports Holdings, Inc.'s directors.

The Complaint in this case contains no particularized facts whatsoever to establish demand futility, instead alleging in a conclusory and highly self-serving fashion that demand should be excused "[b]ased upon the manner in which the business has been operated since the acquisition of assets." Complaint, ¶ 122. In fact, only four directors other than the two defendant directors are even identified by name, and no well-pleaded, *particularized* facts – not one – demonstrating misconduct, bias, disinterestedness or independence on their parts are alleged in the Complaint. Rather, the Complaint alleges simply that:

> it is believed that the remaining directors are relying on [unspecified] input and information provided by Dombrowski and Leffel as support for their [unspecified] actions, and they have not independently assessed the [unspecified] information or formed their own judgment concerning their [unspecified] actions, effectively rendering their [unspecified] conduct beholden to the actions of Dombrowski and Leffel.

Id. Even if true, these circular allegations come nowhere close to establishing demand futility.

The derivative plaintiff in *A.R. DeMarco Enterprises, Inc. v. Ocean Spray Cranberries, Inc.*, No. 19133-NC, 2002 WL 31820970 (Nov. 26, 2002), like Postorivo here, attempted to demonstrate demand futility by referring to the misconduct alleged throughout the complaint. In *DeMarco*, plaintiff brought derivative claims based on the fact that the directors voted against a shareholder resolution to pursue a sale or merger of the corporation:

> According to plaintiff, the directors must be acting in their own self-interest because they are not pursuing a sale or merger. A mere allegation that the board decided not to pursue a sale or merger is not enough to show that the individual directors were not independent or were interested. There must be allegations of interest or lack of independence that lead an individual board member to reject pursuing a sale or merger. A presumption that the directors must be self-dealing simply because they have not done what a plaintiff wants them to do is not a proper basis for demonstrating demand futility.

Id. at *5. The Complaint in this action, like the one in *DeMarco*, is devoid of any allegations of interest or lack of independence that would have led any of the directors to take action adverse to Postorivo, much less to the interests of the corporation. As in *DeMarco*, Postorivo puts the inference before the facts, alleging that because the directors made a decision he does not agree with, the directors must be beholden to Dombrowski and Leffel.

2. The Complaint contains no particularized allegations suggesting that the challenged board actions were anything other than the product of the valid exercise of protected business judgment.

Nor does the Complaint contain any particularized allegations of fact that would suggest that the actions of the board fall outside the protection of the business judgment rule. Under the second prong of *Aronson*, a derivative plaintiff must plead particularized facts that raise a reasonable doubt that "the challenged transaction was otherwise the product of a valid exercise of business judgment." *Aronson*, 473 A.2d at 805. As the Supreme Court held in *Brehm v. Eisner*, pre-suit demand is excused only where "the particularized facts in the complaint create a reasonable doubt that the informational component of the directors' decisionmaking process,

measured by concepts of gross negligence, included consideration of all material information reasonably available" *Brehm,* 746 A.2d at 259 (emphasis in original).

> "[A]bsent particularized allegations to the contrary, the directors are presumed to have acted on an informed basis and in the honest belief that their decisions were in furtherance of the best interests of the corporation and its shareholders." It is not an easy task to allege that a decision falls outside the realm of the business judgment rule because "[t]his Court will not second-guess the judgment of a board of directors if it bases its decision on a rational business purpose." Thus, "[t]he burden is on the party challenging the decision to establish facts rebutting the presumption." In conducting its analysis, the Court must examine the "substantive nature of the challenged transactions and the board's approval thereof."

Khanna, 2006 WL at *23 (footnotes omitted).

The Complaint makes no attempt whatsoever to challenge the applicability of the business judgment rule to any of the challenged actions taken by the board. Rather, the Complaint at best attempts to impugn the disinterestedness of one board member by alleging – in conclusory fashion – that he caused the [unspecified] company to sell inventory at near fire-sale prices "in order to meet certain [unspecified] compensation benchmarks contained in his employment agreement . . . ." Complaint, ¶ 89. Setting aside that fact that this scandalous allegation is unsupported by any "particularized" factual allegations, nothing is alleged that would even tend to suggest that any other board member was involved in this scheme, had any economic interest in this scheme, or would be anything other than fully motivated to protect the rights of the company if such a scheme actually were suggested by real-world facts and circumstances. *See Scopas Technology,* 1984 WL at *4 ("Although Lord alleges that these contested transactions were a waste of corporate assets, such a conclusory statement does not, without more, adequately set forth 'particularized facts' which would allow this Court to draw an inference that approval of [the] transactions was not a valid exercise of business judgment.").

In sum, there are no allegations of particularized fact that would create a reasonable doubt that (1) the KEE Action Sports Holdings Inc. directors are disinterested and independent and (2) the challenged conduct was otherwise the product of a valid exercise of business judgment. The derivative claims must be dismissed for failure to make demand under Court of Chancery Rule 23.1.

VI. CONCLUSION

For the reasons set forth above, AG Paintball Holdings, Inc., Brent Leffel, Raymond E. Dombrowski, Jr., KEE Action Sports Holdings, Inc., KEE Action Sports, LLC, KEE Action Sports I, LLC, and KEE Action Sports UK Limited respectfully request that (1) the claims in the

Complaint purportedly asserted by KEE Action Sports Holdings, Inc. and (2) the derivative claims purportedly asserted by Postorivo on behalf of KEE Action Sports Holdings, Inc. be dismissed with prejudice.

Respectfully submitted,

MONTGOMERY, McCRACKEN, WALKER & RHOADS, LLP

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/s/ R. Montgomery Donaldson

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